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DIRECTORS AND OFFICERS

CHAPTER 1.8

DAVID L. FREEMAN*

INTRODUCTION

The treatment given the sections of the new corporation law relating to officers and directors will be (a) to outline in a general way the main provisions with an indication of their source in most instances; (b) to notice significant departures from pre-existing law; (c) to comment on certain sections which may involve problems of validity or interpretation in the face of judicial test and (d) to make some critical evaluation of certain provisions.

Nineteen sections are involved in this study. While some sections deserve no extended comment, they will nonetheless be reviewed in order, with section titles serving as major headings.

SECTION 12-18.1 BOARD OF DIRECTORS

This section, described by the Reporter as "the basic grant of management authority"¹ provides in full:

Subject to any provisions permitted by chapters 1.1 to 1.14 of this Title to be contained in the articles of incorporation, the by-laws, or agreements among shareholders, the business and affairs of a corporation shall be managed by a board of directors.

The only remote counterpart of this in the old law is the provision that the initial board of directors "shall manage the affairs of the proposed corporation" until their successors are chosen.² Nonetheless, in this instance as well as in many other instances where the old law was either silent or virtually so, our practice has conformed to the notion expressed in the act. The grant of authority itself is from the Model Business

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1. See Reporter's Note, p. 141, DRAFT VERSION, S. C. BUS. CORP. ACT OF 1962. The Reporter's notes furnish a good aid to understanding the new act and, incidentally, reveal the great care and competence of the Reporter himself.

2. S. C. CODE §12-52 (1952).

Corporation Act,³ and, as we have suggested, constitutes no variance from the common understanding of the bar in this state.

The limitation in the first clause of the section subjecting the grant of authority to "otherwise lawful provisions of the articles of incorporation, the by-laws or agreements among shareholders," on the other hand, will involve new avenues to the South Carolina practitioner. The Draft Version indicates that this clause, derived from similar provisions in the Ohio and New York statutes, "is especially designed to aid the close corporation."⁴

An example of its operation is suggested where shareholders of a small family corporation act on a day-to-day basis in managing their business and ignore the formalities of board meetings. The Reporter takes the position that "... such informal action is validated by (Section 12-18.12), and therefore it is 'otherwise lawful' within the meaning of the Section 12-18.1."

It is submitted, that inasmuch as the validation of informal action by directors covered in the section mentioned is accomplished by the Act itself, the example fails to illustrate the usefulness of the provision under discussion. It does, however, suggest that harmony in the operation of that section (and possibly others) with section 12-18.11 could be emphasized if the section under discussion should be phrased to begin "*Subject to other provisions of this Act and,*" etc.

On the other hand, the selection by the Reporter of section 12-16.22 of the act providing for agreements among shareholders respecting management of the corporation as an example where "otherwise lawful" provisions may occur is quite apt.⁵

The determination of what "lawful" provisions may be employed to inhibit the authority the directors might exercise in absence of such provisions would not seem to depend on the terms of the Act alone; that is to say, the court could declare the inhibitory provision "lawful" on general prin-

3. See MODEL BUS. CORP. ACT §33. A three-volume annotated edition of the act, published in 1960 by West Publishing Company, has been helpful to the writer and should be useful to the practitioner.

4. Reporter's Note, p. 141, DRAFT VERSION, S. C. BUS. CORP. ACT OF 1962.

5. Reporter's Note, p. 141, DRAFT VERSION, S. C. BUS. CORP. ACT OF 1962.

ciples though the provision is not specifically made so by the act. It is in this area that practitioners must act with care in deciding what our court would treat as an "otherwise lawful" provision.

SECTION 12-18.2 QUALIFICATION OF DIRECTORS

This section follows the Model Act in providing that "Directors need not be residents of this state or shareholders of the corporation" unless required by the articles or by-laws.⁶ By this section, also, other qualifications for directors may be prescribed in the articles or by-laws.

Under the old law, non-resident directors were permitted,⁷ but at least by implication directors were required to be shareholders.⁸ Operating on the assumption that directors were required to be shareholders, the practice has been (at least with some of the bar) to place "qualifying shares" in the name of the director holding no stock. It is always a happy day for the law when a meaningless fiction finally can be discarded. For those who mourn the passing of old ways, the articles or by-laws may require that the directors be shareholders.

SECTION 12-18.3 NUMBER OF DIRECTORS

This section follows the Model Code in requiring at least three directors;⁹ with an exception allowing less than three directors when there are less than three shareholders but not less than the number of shareholders. Hence, the corporation with one shareholder (which is specifically permitted by the new Act) may operate with one director.

The articles must fix the number of the initial board of directors and this constitutes the authorized number until changed in one of three ways provided in subsection (b) of this section. In each case, it will be observed, authority for the change must derive from shareholder action taken at a meeting where notice of the proposed action has been given.

Subsection (c) in a provision from the Model Code protects the incumbent director against any shortening of his term by a decrease in the number of directors.¹⁰

6. See MODEL ACT §33.

7. S. C. CODE §§12-361-366 (1952).

8. S. C. CODE §12-52 (1952).

9. MODEL ACT §34.

10. MODEL ACT §34.

There are no comparable provisions in the existing law, except a prohibition against more than 17 directors, which the Reporter quite aptly describes as "rather useless." He considers the old provision "impliedly repealed" by this Section which prescribes no maximum number of directors.¹¹ If the prohibition is undesirable, as the writer believes, a specific repeal would be preferable.

SECTION 12-18.4 ELECTION AND TERM OF DIRECTORS

In language taken primarily from section 34 of the Model Act, this section provides for election of all directors at the annual shareholders' meeting except where directors are classified as permitted in section 12-18.5. The members of the initial board hold office until the first annual shareholders' meeting. Sub-section (a) provides that each director holds office for his elected term and until the election and qualification of his successor, or his earlier resignation, removal from office, death or incapacity.

SECTION 12-18.5 CLASSIFICATION OF DIRECTORS

Two types of classification are provided in this section. Subsection (a) permits establishment in the articles of a classification by term of office so as to permit staggered terms when the board of directors shall consist of nine or more members. Its source is the Model Act.¹² Subsection (b) allows the corporation by its articles, where more than one class of stock is involved, to "confer upon the holders of one or more specified classes of shares the right to elect the directors as a whole, or any specified number of them, or the directors of any class or classes established by the articles of incorporation." Its source is the Virginia law.¹³

The latter provision would permit, for example, the articles to empower holders of preferred stock to elect some or even all directors under certain events, such as a protracted default in dividend payments to preferred holders, or with different classes of common stock, the articles might vest the elective power in one or the other, or divide it between such classes.

11. See Reporter's Note, p. 143, DRAFT VERSION, S. C. BUS. CORP. ACT OF 1962.

12. MODEL ACT §35.

13. VA. CODE §13.1-37 (1950).

Both types of classification involve constitutional questions. Article 9, section 11 of the South Carolina Constitution requires the following:

The General Assembly shall provide by law for the election of directors, trustees or managers of all corporations so that each stockholder shall be allowed to cast, in person or by proxy, as many votes as the number of shares he owns multiplied by the number of directors, trustees or managers to be elected, the same to be cast for any one candidate or to be distributed among two or more candidates.

The General Assembly made the required provision.¹⁴

Under the old law, those corporations in this state having preferred stock with the customary absence of voting rights faced the constitutional requirement that "each stockholder" be allowed to vote in the election of directors. While our court has not passed on the point, at least one state with a similar constitutional provision has held that all stock, both preferred and common, has voting rights and that any provision denying such right to the holder of either class is violative of the constitutional requirement.¹⁵

Subsection (b) constitutes an attempt to validate the unfettered vesting of the electoral power as the corporation may see fit. If our court should follow West Virginia, it would be ineffective.

Without the benefit of any survey of the bar, the writer would hazard the view that the constitutional section has generally been treated as a provision for cumulative voting *among those shareholders having voting rights*. Even viewed in this favorable light, the staggered terms provided by subsection (a) fall into question.

Classification by terms of office have the desirable purpose of achieving continuity of management. Under our act the directors may be divided into two or three classes with one class to be elected each year for two or three year terms, depending on the number of classes established by the articles.

But this sort of classification also impairs the cumulative voting right. In an Ohio case,¹⁶ the plaintiff, who held 40%

14. S. C. CODE §12-253 (1952).

15. State *ex rel* Dewey Portland Cement Co. v. O'Brien, 142 W. Va. 451, 96 S. E. 2d 171 (1956).

16. Humphrys v. Winous Co., 165 Ohio St. 45, 133 N. E. 2d 780 (1956).

of the stock in a corporation having cumulative voting, lost all representation on the board when the shareholders holding 60% of the stock provided for the election of one of the three directors each year for three year terms.

It would not be possible to utterly defeat cumulative voting under the new act since classification is available only where there are nine or more directors and no more than three classes may be provided; hence, at least three directors will be elected annually.

But the impairment of the right is present, and the identical section has been held invalid in the face of an Illinois Constitutional provision substantially the same as ours.¹⁷ Cumulative voting, protected by the West Virginia Constitution (in language again in substance like ours) has been held impaired, the court there saying:

As stockholders have the right to vote cumulatively, a plan which prevents the full enjoyment of that right is, to that extent, an ineffectual and substantial denial of the right and illegal.¹⁸

The Pennsylvania court, on the other hand, has upheld classification of directors with staggered terms.¹⁹

It should be observed that the court recognized a difference in the Pennsylvania and Illinois constitutional provisions and the two cases, with no help to our statute, are distinguishable on this basis.

The significance of the constitutional questions to corporate planning under the new law cannot be overlooked. By virtue of our constitutional requirement, corporate control may fall quite contrary to the expectation of those who rely on the provisions of this section.

This uncertainty should not exist. Either the law or the constitution should be changed. Since the provisions of this section are, in the writer's judgment, reasonable and in keeping with the needs of contemporary business organization, an amendment to the constitution insuring their validity should be sought.

17. *Wolfson v. Avery*, 6 Ill. 2d 78, 126 N. E. 2d 701 (1955).

18. *People ex rel Syphers v. McCune*, 143 W. Va. 315, 101 S. E. 2d 834 (1958).

19. *Janney v. Philadelphia Transp. Co.*, 387 Pa. 282, 128 A. 2d 76 (1956).

SECTION 12-18.6 VACANCIES IN THE BOARD OF DIRECTORS

Vacancies in the board, however occurring, are filled by the remaining directors, as provided by this section, unless the articles or by-laws provide otherwise and those elected serve out their predecessor's term. Shareholders, however, fill any vacancies resulting from an increase in the number of directors.

Where a director is elected by holders of a particular class of shares, voting to fill his vacancy is limited to the other directors so elected, or the shareholders of that class. Except for this last mentioned provision, the foregoing is from section 36 of the Model Act. Under the old law in South Carolina, there was no provision covering vacancies on the board.

This section also provides a new rule allowing a director who resigns to postpone the effectiveness of his resignation.²⁰ A vacancy is deemed to exist at the time of written tender. This is designed to serve the convenience of the corporation in electing a successor before the resignation actually takes effect.

SECTION 12-18.7 REMOVAL OF DIRECTORS

In essence, under this section the shareholders who have the power to elect a director also have the power to remove him, with or without cause, and may elect his successor at the same meeting, and the court of the county where the registered office is located, at the suit of shareholders of at least 5% of the number of outstanding shares with or without voting rights, to which suit the corporation shall be made a party, may remove and bar from reelection for a period to be prescribed by the court any director "in case of fraudulent or dishonest acts, or gross abuse of authority or discretion in discharge of his duties to the corporation."

This section has no antecedent in the old statute law. Its provisions are adaptations from section 36 A of the Model Act, and sections of the California, Ohio, North Carolina and New York law.²¹

20. For comparable provisions, see OHIO CODE §1701.58 (1953) and N. C. GEN. ST. §55-27(a) and (d) (1960).

21. CAL. CORP. CODE §§810 and 811; OHIO CODE §1701.58(C) (1953); N. C. GEN. ST. §55.27(g) (1960) and N. Y. CORP. LAW §706(d).

SECTION 12-18.8 TIME AND PLACE OF MEETINGS OF DIRECTORS

Following Model Act section 39, directors may meet either within the state or without, unless the by-laws otherwise provide. This provides desirable certainty on a point not covered by the old law.

The time and place for such meetings may be fixed by the by-laws or, if not so fixed, by the directors.

SECTION 12-18.9 NOTICE OF MEETINGS OF DIRECTORS; PERSONS WHO MAY CALL MEETINGS

In each case the by-laws may prescribe otherwise, but unless they do: (1) regular meetings, the time and place of which are fixed by the by-laws or the board, are held without notice; (2) special meetings upon notice sent by any usual means of communication not less than four days before the meeting and (3) adjourned meetings without any notice if the time and place to which the meeting is adjourned are fixed and announced at the meeting.

Subsection (c) covers the subject of waiver of notice. A director may sign a valid waiver before or after the meeting, and his attendance without protesting the point before the conclusion of the meeting constitutes a waiver. In this last provision, we would question the desirability of allowing a director to participate actively in the meeting to the eve of adjournment and then defeat the whole action by protesting the notice.

It may be that one cannot always say since the director did in fact get to the meeting he is not prejudiced, but subsection (c) provides a further exception to the automatic waiver where the director in effect makes a special appearance, "solely for the purpose of stating his objection, at the beginning of the meeting, to the transaction of any business on the ground that the meeting is not lawfully called or convened."

This would seem ample protection, and the earlier provision of waiver by attendance at a meeting "without protesting prior to its conclusion the lack of or defect in notice of such meeting" would be improved by the omission of the quoted phrase.

It will be observed that the phrase in question does not appear in Model Act section 39, from which the foregoing with some other additions was adapted.

Under subsection (e), a provision also from Model Act section 39, neither the notice or waiver of notice of any directors' meeting need state the purpose or the business to be transacted. Subsection (f) prescribes who may call meetings of the directors in language modeled after the statutes of California and Ohio.²²

There is no provision comparable to this section in the old corporation law of this state.

SECTION 12-18.10 QUORUM AND VOTE OF DIRECTORS

A majority of the directors shall constitute a quorum for the transaction of business, and the board acts by majority vote of those present at a meeting with a quorum. This provision is copied from Model Act section 37 and is in harmony with the old law.²³

A greater proportion may be required either for a quorum or voting by the articles or by-laws.

SECTION 12-18.11 EXECUTIVE AND OTHER COMMITTEES

This allows the creation of "an executive committee and other committees" each of three or more directors by majority resolution of the full board, if the articles or by-laws so provide, and the delegation to such committee or committees of "all the authority of the board of directors" except in five listed instances of major responsibility.

This is declared not to relieve the board or any member of any responsibility imposed by law, and the provisions relating to the conduct of directors' meetings are to govern committee meetings "so far as applicable."

This is a simplified version of Model Act section 38, without antecedent in the old law of this state. While many of the provisions of the new law properly seek to serve the needs of the small corporation, this section may be said to recognize the problems of management in larger corporations.

22. CAL. CORP. CODE §812; OHIO CODE §1701.61(A) (1953).

23. S. C. CODE §12-3 (1952).

SECTION 12-18.12 INFORMAL OR IRREGULAR ACTION BY DIRECTORS

This is a section adapted from North Carolina law²⁴ which the Reporter describes as a "much praised innovation."²⁵

Subsection (a) validates majority action by the directors or a committee of directors without a meeting if either written consent to the action is signed by all directors or committee members and filed with the minutes or all shareholders know of the action and do not promptly object.

Subsection (b) provides that, unless a director or committee member promptly objects after learning of the board or committee action taken at a meeting held without required call or notice which he did not attend, the action shall be "deemed ratified" by him.

Under subsection (c) "prompt objection" is effective only if written objection is filed with the secretary of the corporation.

For practitioners steeped in the law's general requirement that the board of directors and committees must act at a meeting, this section will indeed appear as an innovation. On the other hand, the informal habits of close corporations are familiar to every lawyer.

There are unquestionably advantages to action taken only after deliberation in assembly, in which the valuable "attrition of minds" is supposed to occur. With this section providing the clear chart, any corporation may as a standard practice abandon meetings of the board in favor of informal action. It is one thing to recognize the habits of small corporations, particularly "family" corporations, when the interests of persons doing business with such corporations are involved; it is quite another thing to invite all corporations to establish management by proxy, which we believe subsection (a) does.

In short, while it may not be in the interest of persons doing business with the corporation, it would seem generally in the shareholders' interest that the directors reach their decisions after deliberation and in assembly.

24. N. C. GEN. ST. §55-29 (1960).

25. See Reporter's Note, p. 151, DRAFT VERSION, S. C. BUS. CORP. ACT OF 1962.

Fully recognizing the difficulties of draftsmanship, a middle ground would seem desirable which would protect the outsider who relies on the corporate action but which would otherwise preserve the necessity for action at meetings required under the general law.

Subsection (b) seems to be a reasonable provision, except for the phrasing declaring the effect of the director's failure to object to the action taken at a meeting without required notice. The action is "*deemed ratified.*" Under section 12-18.19 directors are subjected to personal liability for improper dividends and distributions which they "vote for or *assent to.*" We do not believe the authors intended, through their phrasing of the subsection, to leave open the possibility that an absent director might be deemed to have ratified even though he had no knowledge of the impropriety of the meeting or the actions taken, so the danger of this construction ought to be eliminated.

Although our court has excused irregular action as to the directors' meeting place,²⁶ and otherwise expressed a lenient attitude toward close corporations,²⁷ this section is without counterpart in the old corporation statute.

SECTION 12-18.13 ELECTION, QUALIFICATION AND POWERS OF OFFICERS

The new act, following Model Act Section 44, provides for a president, one or more vice presidents if the by-laws so provide, a secretary and a treasurer. While the old law required the president to be a director,²⁸ none of the officers under the new Act need be directors.

The officers are elected by the board, or if the articles expressly provide, by the shareholders. The latter provision, which will have some appeal to small corporations, is based on the Delaware statute.²⁹

The by-laws may prescribe qualifications for officers, the manner of their election and their terms of office, which shall be annual unless otherwise so prescribed.

26. *Freeman v. King Pontiac Co.*, 236 S. C. 335, 114 S. E. 2d 478 (1960).

27. *Industrial Equip. Co. v. Montague*, 224 S. C. 510, 80 S. E. 2d 114 (1954).

28. S. C. CODE §12-53 (1952).

29. DEL. CORP. CODE §142(a) (1953).

Provision is made for such other "officers and assistant officers and agents as may be deemed necessary." They are elected or appointed by the board or in such other manner as the by-laws may prescribe.

One person may hold "any two or more offices" but may act in only one capacity where action by two or more offices is required.

Subsection (f) gives officers and agents the authority and duties provided in the by-laws or by board action not inconsistent with the by-laws.

In a provision from the North Carolina law,³⁰ the president is given authority "to institute or defend legal proceedings" whenever the directors or shareholders are deadlocked. Subsection (g).

The old mandatory requirement of bond by the treasurer³¹ is relaxed by subsection (h). It may be required of "the treasurer or any person performing his duties" if the by-laws so provide.

SECTION 12-18.14 VACANCIES IN OFFICE; REMOVAL OF OFFICERS

Officers or agents elected by the shareholders may be removed only by vote of the shareholders, unless the shareholders have authorized removal by the directors. Otherwise removal is by the board or executive committee. Any vacancy, however occurring, is filled by the directors, unless such power is "specifically reserved" to the shareholders in the articles. Removal from office is declared not to prejudice contract rights, nor are such rights created merely by election or appointment. The provisions of this section are new to our statute law.

SECTION 12-18.15 DUTY OF DIRECTORS AND OFFICERS

This section undertakes to codify the common law duty of directors and officers to the corporation. It requires "that degree of diligence, care and skill which ordinarily prudent men would exercise under similar circumstances in like positions." The Reporter properly notes that "there is no

30. N. C. GEN. ST. §55-34 (1960).

31. S. C. CODE §§12-54, 12-354 (1952).

reason for its being concealed in the cases,"³² but the reported decisions will continue to be important in determining the application of the duty.

SECTION 12-18.16 TRANSACTIONS BETWEEN CORPORATION AND DIRECTORS AND OFFICERS

This section undertakes to establish certainty in an area where the case law of this state has not developed sufficiently to establish a guide. The old corporation law, likewise, furnished no help.

Subsection (a) based upon the California law³³ says that no corporate transaction in which a director or officer has a "personal or adverse interest" shall be void or voidable solely for this reason or because he is present at or participates in or votes at the meeting approving the transaction, if any one of three conditions is established: (1) the directors or a committee approve by vote sufficient without counting the vote of the interested director where the facts are known and noted in the minutes; (2) the shareholders approve by vote sufficient without counting the votes of shares "owned or controlled" by the interested director or officers, again with knowledge of the facts; or (3) the transaction is fair and equitable when authorized or approved, with the burden of showing this being on the party asserting fairness.

While his vote must be excluded, the interested director is counted in determining whether a quorum is present at a meeting. Likewise, the shares of the interested party are included for quorum purposes at the shareholders' meeting. Subsection (c). The corporation would appear reasonably protected so long as the votes of the interested directors or shareholders are excluded, although it should be noted that our court has taken a different view in determining that a quorum was not present at a directors' meeting where it was necessary to count the interested director to make a quorum.³⁴

Subsection (b) undertakes to define the term corporate transaction in which a director or officer has a personal or adverse interest. It is said to include "a contract or other

32. See Reporter's Note, p. 157, DRAFT VERSION, S. C. BUS. CORP. ACT OF 1962.

33. CAL. CORP. CODE §820.

34. Puerifoy v. Loyal, 154 S. C. 267, 151 S. E. 579 (1930).

transaction between a corporation and any of its parent, subsidiary or affiliated corporations.”

It is submitted that the quoted language is not clear. Elsewhere the section has spoken of the personal or adverse interest of “directors and officers.” A “parent, subsidiary or affiliated corporation” is simply not a director or officer, and the language of the whole section is abused when one seeks to fit the quoted language into context. It is not at all clear how one is to apply the other provisions of the section: with respect to directors’ approval, does it mean that all directors are considered interested where the transaction involves a parent, subsidiary or affiliated corporation? And what does it mean with respect to shareholders’ approval?

It would seem preferable to separate the treatment of transactions with related corporations and to spell out more clearly the circumstances under which their validity is to be determined.

One is also led to believe that the inclusion in subsection (b) of transactions with “any corporation, partnership, or association in which one or more of its directors or officers are directors or officers or have a financial interest direct or indirect” creates too broad a sweep. Under this, the corporation’s transaction with General Motors may be affected merely because a director also happens to own some shares of stock in General Motors. In this case if that director’s vote was necessary to the transaction and the matter has not been approved by the shareholders, does General Motors have the affirmative burden of proving that its contract was “fair and equitable to the corporation” before it may expect enforcement? As another example, may either the corporation or the building and loan association act with safety on a loan when a director of the corporation whose vote is necessary also serves, with a negligible financial interest, as a director of the association? And what precisely is an “indirect” interest?

These questions are suggested without any attempt at answer in the hope that the scope of this provision will be reviewed again by the authors before the act becomes effective.

This section also provides for the fixing of compensation of directors by the board or executive committee except as the articles or by-laws otherwise provide. Subsection (d).

**SECTION 12-18.17 LOANS TO DIRECTORS, OFFICERS
AND SHAREHOLDERS**

In a healthy provision based primarily on the California law,³⁵ guarantees of obligations and loans to directors, officers and their nominees of either the lending corporation or an affiliated, parent or subsidiary corporation are prohibited unless approved by at least 2/3 of all shares, voting and non-voting, excluding the shares of the beneficiary or any person under his control. A like prohibition is imposed on any guarantee or loan to anyone upon the security of shares of the corporation or an affiliated, parent or subsidiary corporation.

Directors who authorize or assent to such action become personally liable.

Sales on credit in the ordinary course of business are specifically excluded. Also the section is declared not to apply to certain listed lending institutions or loans permitted under any statute regulating any special class of corporations.

It should be noted that this section does not prohibit loans to employees.

**SECTION 12-18.18 RIGHT OF INDEMNITY OF
DIRECTORS, OFFICERS AND OTHERS**

In a statute filled with provisions which are subject to modification by the articles or by-laws, the one stands out as an instance where the provision is exclusive, and may not be changed by the corporation.

Expenses (including attorney's fees) actually and reasonably incurred in defending any action or proceeding to which one is a party by reason of being or having been an employee of the corporation or a director or officer of the corporation (or at the request of the corporation or another corporation in which it owns shares or of which it is a creditor) are covered in this indemnity statute.

Indemnity is granted and the amount fixed by order of the court either in the proceeding to which one is a party or in a separate proceeding, if the person sued is successful, in whole or in part, on the merits or the proceeding is settled with court approval, and the court finds that the person sued

35. CAL. CORP. CODE §823.

has not been guilty of negligence or misconduct in the performance of his duty to the corporation.

Subsection (c) provides who may make application for indemnity; for the giving of notice of the application; and to whom payment may be made. Under subsection (e) the right of indemnity survives the death of the person entitled thereto.

The indemnity provided is based largely on the California law,³⁶ and is without counterpart under our old statute. The section would appear to achieve a successful balance in affording protection from groundless litigation without subsidizing the wrongdoer.³⁷

SECTION 12-18.19 LIABILITY OF DIRECTORS IN CERTAIN CASES

The liabilities in this section are declared to be "in addition to any other liabilities imposed by law." The directors who "vote for or assent to" the matters prohibited by this section are made jointly and severally liable and the liabilities (except in the case of improper loans or other acts in violation of section 12-18.17) may be enforced (1) by the corporation or any shareholder suing derivatively; (2) by the receiver, liquidator, or trustee in bankruptcy of the corporation or (3) by creditors of the corporation, except where liquidation is in process, or the properties are being administered for the benefit of creditors under court supervision. The creditors may sue the corporation and one or more directors initially, or may get judgment first against the corporation and thereafter in a separate action enforce the liability of any director.

Under subsection (e) a director who is present at any meeting at which "any corporate matter is authorized or taken" shall be presumed to assent unless his contrary vote is entered in the minutes or a written dissent is filed during the meeting or "within a reasonable time after the adjournment thereof." It should be clear that the director who is not in attendance cannot be treated as assenting; however, the "ratification" provided in section 12-18.12, as we noted in

36. CAL. CORP. CODE §830.

37. See Reporter's Note, p. 162, DRAFT VERSION, S. C. BUS. CORP. ACT OF 1962.

the consideration of that section, creates an ambiguity on the point which should be corrected.

This section establishes personal liability in the following cases:

1. For dividends or other distributions in excess of the amounts allowed by the act or the articles;
2. For the amounts paid for the purchase or redemption of its own shares in excess of the amounts properly payable under the act;
3. For distributions in liquidation without taking care of "all known or reasonably ascertainable debts, obligations and liabilities" to the extent the same are not thereafter paid or discharged;
4. For loans or guarantees in violation of section 12-18.17 in the amount of such loans until repayment (together with interest at 6% per year until repaid) or for any liability of the corporation under the guarantee (the liability here being enforceable by those indicated above, except creditors).

The director is not liable if:

1. He relied on financial statements certified in writing by independent accountants or reported by the president or the officer having charge of its books of account to be correct, or
2. If he considered reasonably and in good faith that the assets were of their book value, in determining the amounts available for dividends.

A director is entitled to contribution from other directors who voted for or assented to the improper action, and on motion may have them made parties defendant in any suit against him. Likewise, he is entitled to contribution from shareholders receiving an improper payment "knowing such dividend or distribution or consideration to have been made or paid in violation of this section, in proportion to the amounts received by them respectively."

There is a further right of contribution in the shareholders as among themselves.

This area of liability prior to the adoption of the new law was governed in this state by the common law. Thus liability

was predicated not on bad judgment, but on the absence of good faith or due care. See *Baker v. Mutual Loan and Investment Co.*³⁸

In the main this section follows Model Code section 43.³⁹

The provoking problem raised in the writer's mind by this section is that the very shareholders who receive the dividend or other distribution may by a derivative suit require the directors to restore the distribution to the corporation where it may inure solely to their own benefit.

In one of the leading decisions the Massachusetts court held that though a cause of action existed for capital impairment, it was not enforceable by the shareholders in a derivative action where the corporation was solvent and a going business, the creditors were not prejudiced by the improper dividend and any funds restored by the directors would inure to the benefit of the shareholders who received the dividend in the first place.⁴⁰

In *Baker v. Mutual Loan and Investment Co.*, where directors were held liable on a note executed to cover dividends to preferred shareholders which impaired capital, the Massachusetts case was distinguished on the ground that the common shareholders in *Baker* had an interest in the preservation of the capital assets which would have entitled them to bring suit, the court saying: "These assets could not be depleted by the payment of unearned dividends to one class of stockholders to the injury of another."

It is not at all certain whether our court if confronted with improper payments to common shareholders, where no other interests were involved, would allow recovery in a derivative suit by the shareholders without the provisions of this section. The importance of this point is heightened by the fact that the articles may impose limitations in addition to those contained in the new act on amounts that may be paid out. Thus a corporation may further restrict dividends, perhaps to satisfy the requirement of a creditor imposed as a condition of extending credit to the corporation. The directors might

38. 213 S. C. 558, 50 S. E. 2d 692 (1948).

39. See also OHIO CODE §1701.95 (1953); DEL. CODE §§172 and 174 (1953) and N. C. GEN. ST. §55-32 (1960).

40. *Spiegel v. Beacon Participations*, 297 Mass. 398, 8 N. E. 2d 895 (1937); See also *Loan Soc'y of Philadelphia v. Eavenson*, 248 Pa. 407, 94 Atl. 121 (1915).

well reason that dividends departing from the requirement of the articles could safely be made with the creditor's approval. Under this section, however, the shareholders who received the dividend would seem to have the right to require restoration by the directors without regard to the fact that the creditor, for whose protection the limitation was imposed in the first place, approved the dividend.

Despite the defenses afforded, this section imposes a strict standard of personal liability, which in the writer's opinion goes beyond what one might expect from our court in the application of the common law.

Its provisions, in conclusion, should be viewed with a healthy respect by all directors.